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Ownership and Management Behavior in Post-Transition Societies

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The theoretical claim that ownership matters and that the ownership structure has a strong influence on the behavior of management was most visibly confirmed in Central and Eastern Europe during the transition and post-transition period to market-based democratic societies since 1989. Mass privatization as one of the central tenets of the early period of transition continues to have an enormous influence on the behavior of the managers and on the prospects of firms in the post-privatization period. This is the reason why the unique historical process of mass privatization in Central and Eastern Europe continues to draw the attention of academics, policy-makers, business groups and other groups of people interested in its socio-economic development.

The basic theoretical assumption behind mass privatization was the claim that the Central and Eastern European economies needed to establish "clearly defined property rights" to create proper incentives for firms to start behaving efficiently. Regardless of how initial allocation of property rights would be established, the efficient markets would ensure that the property entitlements would be allocated to the most efficient property holders.

The problem with this theoretical assumption was that it neglected other important legal, economic and regulatory institutions that provide proper incentives for active restructuring and long term competitiveness of the firms. The crucial misunderstanding of the first and second generation of reformers in Central and Eastern Europe was that they frequently mixed the goals and means of transition. In the area of transition, too many reformers viewed privatization as a goal in itself, rather than as a means to achieve goals, i.e. more competitive, more innovative and long-term competitive firms. This is one of the reasons why large scale privatization was conducted in haste, often without the proper regulatory and supervisory framework.

It has turned out, however, that the way the privatization was conducted did matter. The initial design and ownership structure was also more important than previously thought. The regulatory and institutional framework, providing necessary incentives and support to conduct the demanding process of restructuring and improving competitiveness, also mattered. In the context of Central and Eastern Europe, neither a thoughtful approach to the privatization nor a comprehensive regulatory and supervisory framework existed.

According to the comprehensive empirical study by Estrin at al. (2009), almost two decades after the implementation of mass privatization, it is still not possible to clearly recognize that the privatized firms behave substantially more efficiently. It has to be added that the methodological issues relating to the studies of mass privatization effects are truly immense. Nevertheless, according to the study of Estrin et al. on the effects of privatization in transition economies, the finding was that "Privatization per se does not guarantee improved performance, at least in the short and medium run. Type of private ownership, corporate governance, access to know-how and markets, and the legal and institutional system matter for firm restructuring and performance. Foreign ownership tends to have a positive effect on performance. The positive effect of privatization to domestic owners, to the extent it exists, takes a number of years to materialize" (Estrin et al. 2009, 724).

The idea that the accountability of managers spans well beyond the responsibility to the shareholders is something that was well accepted in most of the advanced economies in the twentieth century. This idea may have been lost in the last few decades, but it may return soon. In the context of transition and post-transition, however, the broader idea of accountability of managers to other stakeholders, not only shareholders, carries with it another important but little understood dimension. Namely, in the period of mass privatization, the alliance of dominant shareholders, privileged and protected insiders, managers and interest groups turned out to be a major impediment for sustainable and successful long-term development of firms.

To overcome this impasse, a broader alliance of shareholders, more balanced and diversified, as well as an alliance with other stakeholders must be created. This transformation could be called a transition from privileged and protected rent-seekers toward a genuine development oriented society with balanced and well articulated interests of both the shareholders and stakeholders alike. Only then would the advanced and sophisticated debate on shareholders vs. stakeholders make sense for the transition economies and societies.

Keywords: privatization, ownership structure, long-term commitment, stakeholders, regulatory framework